In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-1491

UNITED TELECOMMUNICATIONS, INC. (Formerly United Utilities, Incorporated),
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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Petitioner, United Telecommunications, Inc. ("United"), seeks review of the judgment of the United States Court of Appeals for the Tenth Circuit, entered on December 29, 1978. The Court of Appeals, affirming the judgment of the United States Tax Court, upheld the validity of the challenged portion of Treasury Regulation § 1.46-3(c)(1) ("Reg."). The challenged portion of said regulation provides that, for investment tax credit purposes, the basis of self-constructed investment credit property ("section 38 property") does not include that element of basis which derives from capitalized depreciation sustained with respect to construction equipment on which investment tax credit has been allowed.

The issue decided by the Court of Appeals presents an important question concerning the construction of the investment tax credit provisions of the Internal Revenue Code which should be considered and resolved by this Court. In particular, the essential question presented is whether the meaning of the term "basis", which is clearly and unambiguously defined as "cost" in section 1012 of the Internal Revenue Code of 1954 ("Code"), may by Treasury regulation and judicial interpretation be given a contradictory and more restrictive meaning in order to achieve what the Commissioner conceives to be a more equitable investment tax credit result.

Moreover, this case involves questions as to which there is a conflict in principle between the decision below and *Commissioner* v. *Idaho Power Co.*, 418 U.S. 1 (1974), and a second conflict in principle between the decision below and *Walt Disney Productions* v. *United States*, 480 F.2d 66 (9th Cir. 1973), *cert. denied*, 415 U.S. 934 (1974), which should be resolved by this Court.

This case presents an issue of significant financial importance to every taxpayer who self-constructs section 38 property and who, in doing so, uses equipment which itself qualifies for some investment tax credit. The Commissioner of Internal Revenue ("Commissioner"), while requiring such a taxpayer to capitalize the applicable depreciation of the construction equipment as part of the basis of the constructed property for all other purposes, would deny that such capitalized depreciation should be included in basis for purposes of computing the investment tax credit on the constructed section 38 property. The result of the Court of Appeals' upholding of Reg. § 1.46-3(c)(1) is that by unauthorized regulatory and judicial fiat the term "basis" as used in Code § 46(c)(1)(A) has been given a new meaning for the particularized circumstances of this case.

OPINIONS BELOW

The opinion of the United States Tax Court, reported at 65 T.C. 278 (1975), is reproduced in the Appendix (A4). The supplemental opinion of the United States Tax Court, reported at 67 T.C. 760 (1977), is reproduced in the Appendix (A31). The opinion of the United States Court of Appeals for the Tenth Circuit, reported at 589 F.2d 1383 (10th Cir. 1978), is reproduced in the Appendix (A38).

JURISDICTION

The judgment of the Court of Appeals was entered on December 29, 1978 (A38), and this Petition is filed within 90 days of the entry of that judgment. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Whether the Court of Appeals, in conflict with the definition of "basis" in Code § 1012 and in conflict with the principles followed by this Court in *Commissioner* v. *Idaho Power Co.*, 418 U.S. 1 (1974), and by the Ninth Circuit Court of Appeals in *Walt Disney Productions* v. *United States*, 480 F.2d 66 (9th Cir. 1973), *cert. denied*, 415 U.S. 934 (1974), erred in upholding the validity of the challenged portion of Reg. § 1.46-3(c)(1) which provides that, for investment tax credit purposes, the basis of self-constructed section 38 property does not include that portion of such basis which derives from capitalized depreciation of the construction equipment used when that equipment itself is section 38 property.

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Relevant portions of §§ 46, 48 and 1012 of the Internal Revenue Code of 1954, 26 U.S.C. §§ 46, 48 and 1012, and of Treasury Regulation § 1.46-3(c)(1) are set out in the Appendix (A1 through A3).

STATEMENT OF THE CASE

All the relevant facts have been stipulated and are summarized in the Tax Court's findings of fact (A5 and A6).

United is a Kansas corporation with its principal place of business at Westwood, Kansas. United has a number of operating subsidiaries, most of which are telephone companies. United and its subsidiaries filed consolidated income tax returns for the years in question (1964 and 1965). The federal income tax returns were filed on the calendar year, accrual basis.

During the years in question, United's subsidiaries regularly used their own motor vehicles and other equipment in the construction of new capital facilities. It has been stipulated that such constructed property qualified as new section 38 property for investment tax credit purposes. On its books, to the extent the equipment was used in construction, United charged depreciation of the equipment to the capital assets so constructed. This was done in accordance with procedures prescribed by the Federal Communications Commission and the Federal Power Commission, as well as the applicable state regulatory agencies, for rate purposes. For federal income tax purposes, United treated the depreciation on the equipment

in the same manner. It capitalized the construction-related depreciation as part of the basis of the new section 38 property and claimed the then applicable three percent investment tax credit with respect thereto. Relying on Reg. § 1.46-3(c)(1), the Commissioner reduced United's investment tax credit basis in new section 38 property by such amounts. United filed a petition in the United States Tax Court to contest the asserted deficiencies.

The Tax Court held that, for purposes of determining qualified investment pursuant to Code § 46(c)(1)(A), on which investment tax credit is calculated, the basis of self-constructed new section 38 property includes only capitalized depreciation sustained with respect to construction equipment on which no investment tax credit has been allowed, and further held that Reg. § 1.46-3(c)(1) is invalid only to the limited extent that it excludes from the basis of the self-constructed new section 38 property capitalized depreciation sustained with respect to construction equipment on which no investment tax credit has been allowed.

The Court of Appeals affirmed the Tax Court's decision, but noted that its opinion differed from that of the Tax Court in that the Court of Appeals preferred the upholding of the validity of the entire regulation here in question.

REASONS FOR GRANTING THE WRIT

I.

This Case Presents Important Questions Concerning the Extent to Which the Commissioner May Disregard Provisions of the Internal Revenue Code in Promulgating a Regulation.

The decision of the Tenth Circuit Court of Appeals in upholding the validity of the challenged portion of Reg. § 1.46-3(c)(1) creates an unauthorized and single application exception to the definition of the term "basis" for federal income tax purposes. There is no statutory justification for this exception; on the contrary, the legislative history makes it clear that Congress intended the term "basis" to be used in its usual sense for investment tax credit purposes.

The Court of Appeals justified its engrafting of an exception of particularized application on the statutory definition of the term "basis" by characterizing the facts of the present case as involving a "double credit" (A40). The Court also justified its decision by adopting the argument that taxing statutes do not permit double deductions (A46 and A47). From these premises the Court of Appeals drew the erroneous conclusion that, while the effect of its decision may be to render the term "basis" as used in Code § 46(c)(1)(A) somewhat ambiguous, that term cannot have a meaning which would permit a "double credit" (A51). Following this rationale, the Court of Appeals upheld the challenged regulation.

It would appear that the fundamental difference between the position of the Court of Appeals and that of United is one of basic jurisprudential principles. Under

United's position the meaning of the term "basis" as used in Code § 46(c)(1)(A) is clear and unambiguous. Such meaning should be applied to the facts of any given situation and the tax consequences determined. If such consequences seem undesirable to the Commissioner, the proper course of action is for him to present the issue to Congress, which can amend the statute if it agrees with the Commissioner that such consequences are undesirable.

Such a course of action is in sharp and fundamental conflict with a practice of "correcting" a statute by administrative legislation so as to preclude a result which the administrative agency has unilaterally determined to be undesirable. However, such administrative legislation is the course which has been approved by the Court of Appeals.

The Court of Appeals started by accepting the Commissioner's argument that, if the term "basis" were applied to the stipulated facts with its usual meaning, United would realize a "double credit" and this would be an undesirable result. On the basis of this conclusion, the Court of Appeals upheld the validity of the challenged regulation which restricted the meaning of the unambiguous statutory term so as to prevent the result deemed to be undesirable. The Court of Appeals thus approved and condoned what is, in the view of United, a clear case of legislation by an administrative agency. The propriety of judicially validating such administrative action is by itself sufficient reason for this Court to grant the requested writ.

As this Court stated in *United States* v. *Calamaro*, 354 U.S. 351, 357 (1957), "Neither we nor the Commissioner may rewrite the statute simply because we may feel that the scheme it creates could be improved upon." *Also*

see T.V.A. v. *Mill*, ... U.S. ...., 57 L. Ed. 2d 117 (1978), where it was stated that:

> "Our individual appraisal of the wisdom or unwisdom of a particular course consciously selected by the Congress is to be put aside in the process of interpreting a statute. Once the meaning of an enactment is discerned and its constitutionality determined, the judicial process comes to an end. We do not sit as a committee of review, nor are we vested with the power of veto. . . .
>
> We agree with the Court of Appeals that in our constitutional system the commitment to the separation of powers is too fundamental for us to pre-empt congressional action by judicially decreeing what accords with 'commonsense and the public weal.' Our Constitution vests such responsibilities in the political Branches." 57 L. Ed.2d at 146-47.

It is United's position that the Court of Appeals should have construed and applied the law as written and should not have attempted to avoid what it perceived to be an undesirable result of that law. *See Commissioner* v. *Standard Life & Accident Ins. Co.*, 433 U.S. 148 (1977); *United States* v. *Cartwright*, 411 U.S. 546 (1973).

Additionally, the decision of the Court of Appeals in this case creates a conflict in principle with this Court's decision in *Commissioner* v. *Idaho Power Co.*, 418 U.S. 1 (1974). In that case, on facts substantially the same as the present case, this Court held that the equipment depreciation allocable to the taxpayer's construction of capital facilities must be capitalized and made a part of the basis of the constructed facility.

Further, the decision of the Court of Appeals in this case creates a conflict in principle with the Ninth Circuit Court of Appeals' decision in *Walt Disney Productions* v. *United States*, 480 F.2d 66 (9th Cir. 1973), *cert. denied*, 415 U.S. 934 (1974). In that case it was held that the taxpayer's basis for depreciation purposes should be used for investment tax credit purposes.

Unfortunately, the Court of Appeals gave rather cursory treatment to the *Idaho Power* and *Walt Disney* decisions, both of which were dismissed as not being precisely equivalent to the present case. This characterization ignores the general principles embodied in those cases which are highly relevant to the present case.

Finally, it should be noted that the present case presents an issue of significant financial importance to every taxpayer who self-constructs section 38 property and who, in doing so, uses equipment which itself qualifies for some investment tax credit. It also should be noted that the present case has important implications regarding capital expansion in the nation's economy. While United does not have any figures as to the precise amount involved, it would appear that hundreds of millions of dollars are invested annually by taxpayers by way of capitalized depreciation. A significant portion of this would be eligible for investment tax credit but for the restriction administratively imposed by Reg. §1.46-3(c)(1). The improper denial of investment tax credit with respect to an aggregate investment of such size amounts to a material frustration of the purpose of the statutes, and the validity of the administrative action challenged here is an issue worthy of this Court's review.

II.

The Court of Appeals Erroneously Held That the Challenged Portion of Regulation § 1.46-3(c)(1) Is Valid.

A. The Portion of Regulation § 1.46-3(c)(1) Relied on by the Commissioner to Exclude Capitalized Depreciation From United's Investment Tax Credit Base in Self-Constructed Section 38 Property Is Invalid Because It Is Contrary to Statute.

The term "basis" is a fundamental one in the Internal Revenue Code and is employed in numerous contexts, including the determination of depreciation, investment tax credit, and gain or loss. As a general definition of that term, Code § 1012 provides that "[t]he basis of property shall be the cost of such property . . . ." It is well settled that under the general and ordinary meaning of "basis" as used in the Code, the basis of a capital asset which is constructed includes not only labor and material costs, but also the depreciation of the equipment owned and used by the taxpayer in the construction of such facility. *See Commissioner* v. *Idaho Power Co.*, 418 U.S. 1 (1974), which is discussed in part II-B of this Petition. Therefore, unless the term "basis" as used in Code §46(c)(1)(A) is by unauthorized regulatory and judicial fiat given a new meaning for the particularized circumstances of this case, the basis for computation of the investment tax credit with respect to the facilities constructed by United's subsidiaries should include the depreciation of the equipment used in such construction.

It is United's position that the challenged portion of Reg. § 1.46-3(c)(1) is in direct conflict with Code § 46(c)(1)(A), which provides that the term "qualified investment" means:

> "(A) the applicable percentage of the *basis* of each new section 38 property (as defined in section 48(b)) placed in service by the taxpayer during such taxable year . . . ." (Emphasis added.)

Code § 48(b) referred to therein provides in part that:

> ". . . In applying section 46(c)(1)(A) in the case of property described in paragraph (1) [new section 38 property], there shall be taken into account only that portion of the *basis* which is properly attributable to construction, reconstruction, or erection after December 31, 1961." (Emphasis added.)

In neither of these statutes is the term "basis" changed in meaning to justify the portion of the regulation in question.

Additionally, no other applicable Code provision furnishes any basis for the limitation imposed by the challenged portion of Reg. § 1.46-3(c)(1). On the contrary, the applicable reports of the House Committee on Ways and Means and Senate Finance Committee confirm the existence of a legislative intent that the basis of assets for purposes of investment tax credit should be determined under the general rules for determining the basis of property. *See* H.R. Rep. No. 1447, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 505; S. Rep. No. 1881, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 847.

Nowhere in those reports is there any authority for the proposition that capitalized depreciation should be excluded from the basis of constructed property for investment tax credit purposes. The legislative history of the investment tax credit provisions makes it clear that Congress used "basis" in Code § 46(c)(1)(A) in its ordinary and usual sense and did not intend any such limitation as that imposed by the challenged portion of the regulation.

It is important to note that when Congress wanted to achieve a different result with respect to the acquisition of *used* section 38 property, it used a different term. Instead of using "basis", it employed the term "cost" and specifically defined that term in Code § 48(c)(3)(B) in a restricted manner for the purpose of used property. The Tax Court in its initial opinion in this case summarized the used property situation as follows:

> "With respect to qualified investment in used section 38 property, the statute's treatment of 'basis' confirms that Congress meant to use 'basis' regarding new section 38 property in its general and ordinary sense as discussed above.
>
> In defining qualified investment in used section 38 property, section 46(c)(1)(B) employs the term 'cost' rather than the term 'basis'. Section 46(c)(1)(B) places on the 'cost' of used section 38 property includable in qualified investment the same percentage limitations (defined by section 46(c)(2) according to useful life) as those placed on the 'basis' of new section 38 property by section 46(c)(1)(A). *'Cost' is defined by section 48(c)(3)(B), and differs significantly from the term 'basis' as used by section 48(b).*
>
> * * *
>
> The report of the Senate Finance Committee explains these provisions as follows:
>
> > To prevent a double allowance where used property is traded in on used property, or where used property is disposed of (otherwise than by casualty or theft) and other used property 'similar or related in service or use' is acquired as a replacement, the cost otherwise allowable for the used property acquired is reduced by the adjusted basis of the property disposed of in both of these types of cases.
>
> *With respect to the cost of used section 38 property includable in qualified investment, and thus eligible for the section 38 credit, it is clear that Congress sought to prevent a doubling effect of the credit by restricting the meaning of basis. It is also clear that Congress did not place these restrictions on the basis of new section 38 property.*" 65 T.C. at 282-3. (Emphasis added.)

If Congress had intended to do so, it would have limited the term "basis" in new property situations in a manner similar to the special provision employed with respect to used property. That it did not do so is clearly not a result of oversight.

B. This Court's Decision in the Idaho Power Case Requires the Capitalization of Depreciation of Equipment Used to Construct Capital Assets.

In *Commissioner* v. *Idaho Power Co.*, 418 U.S. 1 (1974), this Court considered the issue of whether, for federal income tax purposes, a taxpayer is entitled to a deduction from gross income under Code § 167(a) for depreciation on equipment the taxpayer owns and uses in the construction of its own capital facilities, or whether the capitalization provisions of Code § 263(a) bar the deduction. This Court held that the equipment depreciation allocable to the taxpayer's construction of capital facilities must be capitalized.

The facts in the *Idaho Power* case are substantially the same as those in the instant case. In that case, the taxpayer was a public utility engaged in the production, transmission, distribution, and sale of electric energy. The

taxpayer used its own equipment in the construction of its capital facilities. On its books, to the extent the equipment was used in construction, the taxpayer charged depreciation of the equipment to the capital asset so constructed. This was done either directly or through clearing accounts in accordance with procedures required by the Federal Power Commission and the state regulatory agency. However, for income tax purposes, that depreciation was claimed as a current deduction under Code § 167(a).

This Court held that such a deduction was improper and required that the depreciation so disallowed be added to the taxpayer's basis in its capital facilities (with a deduction being permitted for an appropriate amount of depreciation computed over the useful life of the property constructed). It is United's contention that this Court's holding in *Idaho Power* is dispositive of the issue in the present case: capitalized depreciation is a part of basis, whether for depreciation purposes or for investment tax credit purposes.

It should be noted in its rationale the Court stated:

> ". . . where a taxpayer's generally accepted method of accounting is made compulsory by the regulatory agency and that method clearly reflects income, it is almost presumptively controlling of federal income tax consequences." *Id.* at 15.

In the present case, United's generally accepted method of accounting is made compulsory by the Federal Communications Commission, the Federal Power Commission, and the applicable state regulatory agencies, for rate purposes. There is no evidence that the accounting method does not clearly reflect income. On the contrary, it does clearly reflect income.

Another factor in this Court's decision in *Idaho Power* was the desire of the Court to achieve parity between taxpayers who do their own construction work and taxpayers who have their construction work done by independent contractors. In this regard, the Court reasoned as follows:

> "An additional pertinent factor is that capitalization of construction-related depreciation by the taxpayer who does its own construction work maintains tax parity with the taxpayer who has its construction work done by an independent contractor. The depreciation on the contractor's equipment incurred during the performance of the job will be an element of cost charged by the contractor for his construction services, and the entire cost, of course, must be capitalized by the taxpayer having the construction work performed. The Court of Appeals' holding would lead to disparate treatment among taxpayers because it would allow the firm with sufficient resources to construct its own facilities and to obtain a current deduction, whereas another firm without such resources would be required to capitalize its entire cost including depreciation charged to it by the contractor." *Id.* at 14.

If this rationale is applied to the instant case, United will be allowed to include capitalized depreciation in its investment tax credit base in self-constructed section 38 property. To do so merely places United in the same position that it would have occupied had it purchased, rather than constructed, the new capital assets. If United had caused its construction work to be performed by an independent contractor, there would be no question but that it would be entitled to the investment tax credit thereon. As this Court acknowledged, the price paid to the independent contractor would include the depreciation

on the contractor's equipment incurred during the performance of the job. The independent contractor not only would be entitled to currently deduct such depreciation, but also would be entitled to investment tax credit on such equipment.

C. The Court of Appeals for the Ninth Circuit Has Held That Basis for Investment Tax Credit Purposes Is the Same As for Depreciation Purposes.

In *Walt Disney Productions* v. *United States,* 480 F.2d 66 (9th Cir. 1973), *cert. denied,* 415 U.S. 934 (1974), the Ninth Circuit Court of Appeals held that the taxpayer's basis for depreciation purposes should be used to compute its investment tax credit. In that case, the taxpayer had claimed the investment tax credit on motion picture negatives produced by it in 1962. The negatives, which were not copyrighted, were used to make copyrighted prints which were then exhibited in movie theaters and on television. The Commissioner contended that the films were not "tangible personal property" under Code § 48(a)(1)(A), relying on Reg. § 1.48-1(f). The Commissioner made the alternative contention that even if the films were tangible personal property, they were not entitled to the full investment tax credit because they did not have a useful life of eight years or more. The Court of Appeals rejected both contentions and held the films qualified for the investment tax credit. In doing so, it held Reg. § 1.48-1(f) invalid.

The lower court had not allowed the taxpayer to take the investment tax credit on the full basis that the taxpayer had used for depreciation purposes, but limited it to "those costs which are directly related to the finished negative." This figure was defined by multiplying hourly labor and certain other costs by a fraction, the numerator

of which was the footage of the final film and the denominator of which was the total footage shot. The Ninth Circuit Court of Appeals held that this limitation was unwarranted, stating that:

> "There is no indication that the term 'basis' as used in § 46(c)(1)(A) was to have other than its customary meaning as including the whole cost of the property produced. Int. Rev. Code of 1954, § 1012. Indeed, the requirement in § 48(g), repealed, Revenue Act of 1964, Pub. L. No. 88-272, § 203(a)(1), 78 Stat. 33, that the basis for purposes of depreciation shall be reduced by the amount of the investment credit *compels the conclusion that 'basis' was not intended to have an idiosyncratic meaning in* § *46*(c)(*1*)(*A*). Accordingly, the judgment of the district court is modified to allow the taxpayer to use its depreciation basis to compute its investment credit." 480 F.2d at 69. (Emphasis added.)

D. The Court of Appeals Based Its Decision on the Erroneous Acceptance of the Concept of "Double Credits".

The opinion of the Court of Appeals is based on acceptance of the Commissioner's argument that United is seeking a "double credit"—a windfall not available to taxpayers generally and not intended by Congress.

If "double credit" is intended to imply the realization of two investment tax credits on the same investment, it is erroneous when applied to United's situation. When a piece of equipment, such as a truck, is used in constructing a telephone facility, such as telephone lines, there are clearly two separate properties and investments involved. From a physical identity standpoint, the truck and the telephone lines are obviously different properties. The

truck and the telephone lines are equally separate from an accounting standpoint; the truck has its own accounting identity and cost basis, and the fact that a portion of the truck's depreciation is mandatorily capitalized as part of the cost of the telephone lines, which also have their own accounting identity and basis, does not prevent the lines from being a separate investment and item of property. The investment tax credit is realized upon acquisition of section 38 property; the realization of investment tax credit with respect to each of two separate acquisitions of qualified property does not amount to a "double credit".

The term "double credit" is equally erroneous in its implication that the position of United seeks to create an unintended windfall not otherwise available to taxpayers, *i.e.*, the realization of multiple investments stemming from a single initial investment. The realization of multiple credits by a single taxpayer on the basis of the same initial investment is not uncommon and is fully within the intendment of Congress. One example is the trade-in situation, where a qualified piece of property is acquired, used for a number of years, and traded for another item of new, qualified property before its initial cost is fully depreciated; in this instance the taxpayer realizes investment tax credit on the full cost of the first asset, has no recapture on its trade-in if the period of use is sufficient, and realizes investment tax credit on the complete cost basis of the property for which it is traded, including that portion of its basis which is carried over from the first asset. This clearly involves a "double credit" with respect to that element of cost which formed part of the basis of both assets, yet the right to such credit is never questioned. Another example of multiple credits arising from a single investment is the situation wherein a productive asset is acquired, with resultant tax savings through

investment tax credit, and such savings are invested in a second productive asset which generates a second investment tax credit; there has been a "double credit" on the initial cost element equal to the investment tax credit on the first asset.

While the examples noted above might be said to represent special situations, the fact is that the operating cycle of nearly every business involves a conversion of assets from one form into another, with resulting realization of multiple investment tax credits stemming from the same initial investment. In the telephone business, this cycle might be described as follows: (a) cash is invested in a productive asset, such as a truck, resulting in an investment tax credit; (b) the truck is used in operations to generate services, which are sold and generate accounts receivable, the truck thus being converted (through depreciation charges) into receivables; (c) the receivables are converted into cash by collection; and (d) the cash or a portion thereof is expended in acquiring a new productive asset, such as telephone lines, with a resulting investment tax credit. This cycle is repeated over and over again, with the initial cash investment resulting in the taxpayer's realization of many taxable revenues and many investment tax credits. In the intsant situation, where taxpayer uses a truck to construct telephone lines, the cycle is merely shortened. The intermediate elements are bypassed and the first productive asset, the truck, is converted directly into the second porductive asset, the telephone lines. The taxpayer's realization of investment tax credit on each productive asset should not suddenly be deemed a "double credit"—an evil to be precluded by administrative or judicial legislation.

An early undistributed profits tax decision of this Court should also be taken in account when considering

the propriety of multiple credits. In *Helvering* v. *Sabine Transportation Co.*, 318 U.S. 306 (1943), the taxpayer paid dividends of $560,000 in 1937, $30,000 of which was paid in cash and $530,000 of which was paid in the form of its notes. The taxpayer was allowed a "dividends paid credit" therefor with respect to its 1937 tax, pursuant to the Revenue Act of 1936. This credit was a deduction from income. The following year the taxpayer redeemed the notes from its stockholders for $530,000 and claimed a "dividends paid credit" for that amount with respect to its 1938 tax, pursuant to the Revenue Act of 1938. This credit was a credit against the tax. The Commissioner contended that the second credit claimed would duplicate the earlier one and that the Revenue Act of 1938 did not permit the duplication. The Commissioner argued that:

> ". . . Congress did not intend the taxpayer to have two credits as a result of payment of a dividend in its own obligations, that exemptions or credits should be strictly construed as against the taxpayer, and that the regulations promulgated under the Revenue Act of 1938 clearly deny the deduction claimed in this case." *Id.* at 310.

The Court rejected the Commissioner's position and held that the taxpayer was entitled to the second credit. In so doing, the Court stated:

> "It remains to consider the Treasury Regulations promulgated under the 1938 Act. These forbid a credit such as that claimed in this case, calling it a 'double credit'. *We think the regulations are in the teeth of the unambiguous mandate of the statute, are contradictory of its plain terms, and amount to an attempt to legislate.* They cannot prevail to preclude the credit claimed." *Id.* at 311-12. (Emphasis added.)

To assume that multiple credits are *per se* impermissible ignores the fact that the purpose of the investment tax credit statutes was to encourage capital investment and the creation of the property, in short, to foster the very transactions which give rise to such multiple credits. A taxpayer who acquires qualified property and uses it in the construction of other new section 38 property is acting in direct furtherance of the purposes of the investment tax credit statutes, and the realization of a so-called double credit by such a taxpayer does not in any manner constitute an abuse of the statute.

III.

If the Challenged Portion of Regulation § 1.46-3(c)(1) Is Valid, the Court of Appeals Erroneously Held That the Tax Court's Rule 155 Computation Was Correct.

Should this Court grant the requested Writ of Certiorari and should this Court affirm the decision of the Court of Appeals, it is United's position that it then is entitled to receive an investment tax credit with respect to capitalized depreciation where no so-called double credit occurs. Such a situation occurred with respect to United's construction equipment which had a useful life of more than four, but less than eight, years.

In the years in question, United acquired and used such short-life equipment in self-constructing property eligible for investment tax credit and the depreciation of the construction equipment was capitalized in connection therewith. However, United received only a reduced amount of investment tax credit on its investment in such construction equipment because it had a useful life of less than eight years. No "double credit" results from allowing investment tax credit on that portion of the self-constructed

property basis which derives from capitalized depreciation of the nonqualifying portion of the construction equipment's basis. Therefore, investment tax credit based upon such inclusion should be allowed to United, pursuant to the Rule 155 computation statement submitted by United in the Tax Court proceeding.

CONCLUSION

For all of the foregoing reasons, Petitioner respectfully requests that a Writ of Certiorari issue to review the judgment of the Court of Appeals for the Tenth Circuit.

Respectfully submitted,

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APPENDIX

STATUTORY AND REGULATORY PROVISIONS INVOLVED

The pertinent sections of the Internal Revenue Code and the challenged Treasury Regulation for the period in question are:

Section 46(c)(1), 26 U.S.C. § 46(c)(1), provided:

"(c) QUALIFIED INVESTMENT.—

(1) IN GENERAL.— For purposes of this subpart, the term 'qualified investment' means, with respect to any taxable year, the aggregate of—

(A) the applicable percentage of the basis of each new section 38 property (as defined in section 48(b)) placed in service by the taxpayer during such taxable year, plus

(B) the applicable percentage of the cost of each used section 38 property (as defined in section 48(c)(1)) placed in service by the taxpayer during such taxable year."

Section 48(b), 26 U.S.C. § 48(b), provided:

"(b) NEW SECTION 38 PROPERTY.— For purposes of this subpart, the term 'new section 38 property' means section 38 property—

(1) the construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or

(2) acquired after December 31, 1961, if the original use of such property commences with the taxpayer and commences after such date.

In applying section 46(c)(1)(A) in the case of property described in paragraph (1), there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection after December 31, 1961."

Section 1012, 26 U.S.C. § 1012, provided:

"The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses). The cost of real property shall not include any amount in respect of real property taxes which are treated under section 164(d) as imposed on the taxpayer."

Treas. Reg. § 1.46-3(c)(1) provided:

"(c) BASIS OR COST. (1) The basis of any new section 38 property shall be determined in accordance with the general rules for determining the basis of property. Thus, the basis of property would generally be its cost (see section 1012), unreduced by the adjustment to basis provided by section 48(g)(1) with respect to property placed in service before January 1, 1964, and any other adjustment to basis, such as that for depreciation, and would include all items properly included by the taxpayer in the depreciable basis of the property, such as installation and freight costs. However, for purposes of determining qualified investment, the basis of new section 38 property con-

structed, reconstructed, or erected by the taxpayer shall not include any depreciation sustained with respect to any other property used in the construction, reconstruction, or erection of such new section 38 property. (See paragraph(b)(4) of § 1.48-1). If new section 38 property is acquired in exchange for cash and other property in a transaction described in section 1031 in which no gain or loss is recognized, the basis of the newly acquired property for purposes of determining qualified investment would be equal to the adjusted basis of the other property plus the cash paid. See § 1.48-4 for the basis of property to a lessee where the lessor has elected to treat such lessee as a purchaser."

65 UNITED STATES TAX COURT REPORTS

UNITED TELECOMMUNICATIONS, INC. (FORMERLY UNITED UTILITIES INCORPORATED), PETITIONER v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 7866-72. Filed November 10, 1975.

Petitioner's subsidiaries constructed their own telephone and power plant properties which qualify as "new section 38 property" as defined by sec. 48(b). *Held*, for purposes of determining qualified investment pursuant to sec. 46(c)(1)(A) on which the sec. 38 credit against tax is calculated, the basis of the self-constructed new sec. 38 property includes depreciation sustained with respect to a constructing asset on which no sec. 38 credit has been allowed. *Held, further*, sec. 1.46-3(c)(1), Income Tax Regs., is invalid to the limited extent that it excludes from the basis of the self-constructed new sec. 38 property depreciation sustained with respect to constructing assets on which no sec. 38 credit has been allowed.

William H. Curtis, George F. Crawford, and *Allan W. Stopperan*, for the petitioner.

Joe K. Gordon, for the respondent.

FORRESTER, *Judge*: Respondent has determined deficiencies in petitioner's income tax in the amounts of $31,448.85 and $119,777.13 for taxable years 1964 and 1965, respectively. Petitioner claims a refund in the amount of $146,595.72 for taxable year 1964. Concessions having been made, the sole issue remaining for our decision is whether, for purposes of computing the petitioner's quali-

fied investment eligible for the section 38[1] credit against tax, the basis of certain capital assets and improvements qualifying as new section 38 property constructed by petitioner includes depreciation on property used in the construction of those capital assets.

FINDINGS OF FACT

All of the facts have been stipulated and are so found. Those necessary to an understanding of the issue are set out below.

Petitioner United Telecommunications, Inc., formerly United Utilities, Inc. (hereinafter sometimes referred to as United), is a corporation formed under the laws of Kansas and having its principal office at Westwood, Kans., at the time the petition was filed. Petitioner filed consolidated income tax returns for 1964 and 1965 on behalf of itself and its operating subsidiaries on a calendar year, accrual basis with the District Director of Internal Revenue, Wichita, Kans.

Petitioner has a number of operating subsidiaries each of which is incorporated under the laws of the particular State in which it transacts business. Most of petitioner's subsidiaries are telephone companies, and one provides electric, natural gas, and water services. The operations and accounting methods of these subsidiaries are subject to regulation by the States in which their businesses are conducted.

Petitioner's subsidiaries regularly use their own motor vehicles and other equipment in the construction of new telephone plant property and electric, gas, and water plant property, which qualifies as new section 38 property.

1. All statutory references are to the Internal Revenue Code of 1954, as applicable to the years herein involved, unless otherwise specified.

It has been the practice of these subsidiaries to capitalize the applicable depreciation of such equipment as part of the cost basis of the new property in the construction of which it is used, pursuant to requirements of Federal and State regulatory agencies having jurisdiction over each subsidiary.

The cost basis so calculated has been used for purposes of depreciating the new property and for purposes of computing the investment credit.

During 1964 and 1965, the amount of capitalized depreciation relating to the construction of new section 38 property with a useful life of 8 years or more and included in those properties' investment credit base, by subsidiary, was as follows:

Subsidiary	*Amount 1964*	*Amount 1965*
United Telephone Co. of Arkansas	$2,608.53	$2,410.40
United Telephone Co. of the Carolinas	6,744.09	4,449.57
United Telephone Co. of Indiana	18,219.63	26,047.34
United Telephone Co. of Kansas	13,707.73	13,930.62
United Telephone Co. of Iowa	—	4,905.55
United Telephone Co. of Missouri	19,958.02	23,156.13
United Telephone Co. of New Jersey	3,461.29	4,476.66
United Telephone Co. of the Northwest	14,707.12	16,557.02
The United Telephone Co. of Pennsylvania	23,869.16	29,998.91
United Telephone Co. of the West	3,240.38	4,161.42
United Telephone Co. of Southern Indiana	—	1,870.92
Central Kansas Power Co.	8,191.86	9,904.40
Lincoln-Tillamook Telephone Co.	2,201.76	3,916.57
Ohio Telephone Service Co.	5,840.79	7,464.19
New Jersey Telephone Co.	3,908.99	5,294.32
	126,659.35	158,544.02

OPINION

The sole issue presented for our decision is one of first impression. It is (for purposes of computing the qualified investment on which the section 38 credit against tax is calculated): is the petitioner entitled to include in the basis of self-constructed telephone and power plant properties that qualify as new section 38 property the capitalized depreciation of property used in its construction?[2]

United contends that the term "basis," as used in section 46(c)(1)(A)[3] with respect to the "qualified investment" upon which section 38 allows a credit against income tax, and as used in section 48(b)[4] defining "new section 38 property," should be given its general and ordinary meaning. Petitioner rightly states that the economic basis

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2. To promote simplicity, this opinion hereafter refers only to petitioner though it was petitioner's subsidiaries which constructed the new sec. 38 property.

3. SEC. 46(c). QUALIFIED INVESTMENT.—

(1) IN GENERAL.— For purposes of this subpart, the term "qualified investment" means, with respect to any taxable year, the aggregate of—

(A) the applicable percentage of the basis of each new section 38 property (as defined in section 48(b)) placed in service by the taxpayer during such taxable year * * *

4. SEC. 48(b). NEW SECTION 38 PROPERTY.— For purposes of this subpart, the term "new section 38 property" means section 38 property—

(1) the construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or

(2) acquired after December 31, 1961, if the original use of such property commences with the taxpayer and commences after such date.

In applying section 46(c)(1)(A) in the case of property described in paragraph (1), there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection after December 31, 1961.

of its constructed properties includes amounts of depreciation on assets used by petitioner to construct those capital assets and improvements. *Commissioner* v. *Idaho Power Co.*, 418 U.S. 1 (1974). Therefore, United argues, because there is no indication that Congress meant to give "basis" as used in the pertinent sections any other definition than its normal meaning, that portion of section 1.46-3(c)(1), Income Tax Regs., emphasized below is invalid as being contrary to the statute:

> Sec. 1.46-3(c) *Basis or cost.* (1) The basis of any new section 38 property shall be determined in accordance with the general rules for determining the basis of property. Thus, the basis of property would generally be its cost * * * and would include all items properly included by the taxpayer in the depreciable basis of the property * * * *However, for purposes of determining qualified investment, the basis of new section 38 property constructed, reconstructed, or erected by the taxpayer shall not include any depreciation sustained with respect to any other property used in the construction, reconstruction, or erection of such new section 38 property.* [Emphasis supplied.]

Respondent has broad authority to effect the purpose of the statute by promulgating regulations. *Commissioner* v. *South Texas Co.*, 333 U.S. 496 (1948). Where, as with the investment credit provisions, Congress has specifically given respondent authority to prescribe regulations necessary to carry out the statute's purpose,[5] respondent's regulations are entitled to a heavy presumption of validity. *Fawcus Machine Co.* v. *United States*, 282 U.S. 375 (1931); *Robert E. Catron*, 50 T.C. 306, 309 (1968). However, the statute always remains the primary authority and to the

5. Sec. 38(b).

extent respondent legislates, thereby exceeding his authority to interpret the statute, his promulgation is void. *Manhattan Co.* v. *Commissioner*, 297 U.S. 129 (1936); *Boykin* v. *Commissioner*, 260 F. 2d 249 (8th Cir. 1958), modifying 29 T.C. 813 (1958); *Northern Natural Gas Co.* v. *O'Malley*, 277 F. 2d 128 (8th Cir. 1960); *Fabian Tebon, Jr.*, 55 T.C. 410 (1970).

In examining the challenged portion of section 1.46-3(c)(1), Income Tax Regs., quoted above, in the light of sections 46(c)(1)(A), 47(a)(1), and 48(b), we conclude that the regulation is valid in part and invalid in part.

The Revenue Act of 1962, 76 Stat. 960, added to the Internal Revenue Code of 1954 the investment credit against income tax. Subject to certain limitations, the amount of investment credit allowed by section 38 is generally 7 percent of the taxpayer's "qualified investment." Sec. 46(a)(1). "Qualified investment" with respect to new section 38 property, the kind here involved, is defined by section 46(c)(1)(A). This section provides that such qualified investment is equal to an applicable percentage of the taxpayer's basis in new section 38 property. The applicable percentage depends upon the estimated useful life of the new section 38 property as set forth in section 46(c)(2).[6]

In applying section 46(c)(1)(A) to constructed section 38 property, the statute places only one restriction on the meaning of "basis" and that restriction is contained in section 48(b). "Basis" is limited to that portion of the

6. Because the constructed sec. 38 property in this case has a useful life of more than 8 years, the petitioner is entitled to include in qualified investment 100 percent of its basis in the property. However, because petitioner is a public utility, its qualified investment is limited to three-sevenths of this amount by sec. 46(c)(3).

basis which is properly attributable to construction, reconstruction, or erection after December 31, 1961.

Both the House and Senate technical explanations of the bill contain identical statements regarding the basis of new section 38 property, as follows:

> The basis of "new section 38 property" is to be determined under the general rules for determining the basis of property. Thus, the basis of property purchased or constructed would generally be its cost. * * *[7]

Thus, it appears that Congress intended to make no distinction between purchased or constructed new section 38 property regarding the meaning of "basis," and furthermore, that Congress intended "basis" to be used in its general and ordinary sense; i.e., "cost." See sec. 1012.

With respect to qualified investment in used section 38 property, the statute's treatment of "basis" confirms that Congress meant to use "basis" regarding new section 38 property in its general and ordinary sense as discussed above.

In defining qualified investment in used section 38 property, section 46(c)(1)(B) employs the term "cost" rather than the term "basis." Section 46(c)(1)(B) places on the "cost" of used section 38 property includable in qualified investment the same percentage limitations (defined by section 46(c)(2) according to useful life) as those placed on the "basis" of new section 38 property by section 46(c)(1)(A). "Cost" is defined by section 48(c)(3)(B), and differs significantly from the term "basis" as used by section 48(b).

7. H. Rept. No. 1447, 87th Cong., 2d Sess., 1962-3 C.B. 405, 505; S. Rept. No. 1881, 87th Cong., 2d Sess., 1962-3 C.B. 707, 847.

Section 48(c)(3)(B) mandates a reduction in the basis of used section 38 property which is acquired as a replacement for, and is similar or related in use or service to used section 38 property disposed of by the taxpayer by the amount of the adjusted basis of the property disposed of.[8] The amount determined after such reduction in basis is the "cost" of the used section 38 property that is used to compute qualified investment. Section 48(c)(3)(B) also excludes from "cost" so much of the basis of the acquired used section 38 property as is determined by reference to the adjusted basis of other property held at any time by the taxpayer acquiring the used property. However, where there has been a recapture of investment credit pursuant to section 47 with respect to the property disposed of, the two foregoing restrictions on basis that are applied to determine cost are not applied. Sec. 1.48-3(b)(3), Income Tax Regs.; see also examples contained in sec. 1.48-3(b)(4), Income Tax Regs.

The report of the Senate Finance Committee explains these provisions as follows:

> To prevent a double allowance where used property is traded in on used property, or where used property is disposed of (otherwise than by casualty or theft) and other used property "similar or related in service or use" is acquired as a replacement, the cost otherwise allowable for the used property acquired is reduced by the adjusted basis of the property disposed of in both of these types of cases.[9]

8. See Sec. 1.48-3(b)(2), Income Tax Regs., where application of the reduction in basis has been limited to replacements made within a 60-day period preceding or following the disposition.

9. S. Rept. No. 1881, *supra*, 1962-3 C.B. at 721-722; to the same effect see the report of the House Ways and Means Committee at 1962-3 C.B. 415.

With respect to the cost of used section 38 property includable in qualified investment, and thus eligible for the section 38 credit, it is clear that Congress sought to prevent a doubling effect of the credit by restricting the meaning of basis. It is also clear that Congress did not place these restrictions on the basis of new section 38 property.[10]

Congress intended the investment credit as a stimulus to encourage capital investment by reducing the net cost of acquiring assets. Regarding the economic effect of the credit, the report of the Senate Finance Committee stated the following:

> The objective of the investment credit is to encourage modernization and expansion of the Nation's productive facilities and thereby improve the economic potential of the country, with a resultant increase in job opportunities and betterment of our competitive position in the world economy. The objective of the credit is to reduce the net cost of acquiring new equipment; this will have the effect of increasing the earnings of new facilities over their productive lives and increasing the profitability of productive investment. It is your committee's intent that the financial assistance represented by the credit should itself be used for new investment, thereby further advancing the economy. Only in this way will the investment credit fully serve the overall national interest in greater productivity, a healthy and sustained economic growth, and a better balance in international payments.[11]

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10. Compare subsecs. (b) and (c)(1) and (3) of sec. 48.

11. S. Rept. No. 1881, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 707, 717-718. The reports of both the House Ways and Means Committee and the Conference Committee on the Revenue Act of 1962 are to the same effect. See H. Rept. No. 1447, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 405, 411, 412; Conf. Rept. No. 2508, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 1129, 1142.

Consistent with the overall policy to stimulate the economy, Congress enacted section 47(a)(1) to provide against those abusive cases where the sole inducement to dispose of and acquire section 38 property was the investment credit. Both the House and Senate committee reports indicate that the primary purpose of this recapture provision was— "To guard against a quick turnover of assets by those seeking multiple credit."[12]

The effect of section 47 is to allow a double credit to the extent no recapture is effected. Recapture is effected only to the extent the estimated useful life of the asset was longer than its actual life or service. Sec. 47(a)(1); sec. 1.47-1(a)(2)(i), Income Tax Regs. Thus, if section 38 property is disposed of or otherwise ceases to be section 38 property prior to the termination of its estimated useful life for purposes of determining qualified investment under section 46(c), then in the year of disposition or cessation, a recomputation of qualified investment must be made by applying section 46(c)(2) to the actual number of years the property was used by the taxpayer as section 38 property. If the recomputation results in a decrease of investment credit allowable with respect to that property, then the taxpayer must increase his tax or reduce his investment credit carryover by the amount of the decrease. Sec. 47(a)(1) and (3); sec. 1.47-1(a)(1)(i), Income Tax Regs.

For example, if the estimated useful life of new section 38 property is 7 years, the section 38 credit is computed on the qualified investment determined by section 46(c) to be equal to two-thirds of its basis. If the asset is traded in for new section 38 property after 5 years, the credit on the property traded is recomputed as if its actual

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12. H. Rept. No. 1447, *supra*, 1962-3 C.B. at 417; S. Rept. No. 1881, *supra*, 1962-3 C.B. at 724.

life were 5 years. Thus, the credit is still allowed on the qualified investment which is equal to one-third of its original basis. Secs. 47(a)(1), 46(c). Moreover, the credit is allowed on the total purchase price of the new section 38 property acquired, limited only by the applicable percentages of section 46(c)(2) according to its useful life. Therefore, to the extent the basis of the new section 38 property is determined by reference to the basis of the property traded, on which there is partial or no recapture, there is a double allowance of the credit. To the extent investment credit is recaptured, there is no double allowance.

Respondent maintains that petitioner's position requires a result that effectively grants a double investment credit: first on the basis of acquired qualified property; second on the basis of that same property to the extent it is capitalized as construction-related depreciation and included as a construction cost in the basis of constructed section 38 property. Petitioner argues that, even so, there is no statutory support for respondent's regulation which is unreasonable in its definition of the basis of constructed section 38 property for determining qualified investment.

The key to resolution of the issue in the instant case is found in the definition of "section 38 property" contained in section 48(a)(1). This section provides that "section 38 property" means, inter alia, tangible personal property, but includes "only property with respect to which depreciation * * * is allowable and having a useful life * * * of 4 years or more." Thus, if in a given taxable year a depreciation deduction is not allowable on property, then that property ceases to qualify as section 38 property. Sec. 1.48-1(b)(1), Income Tax Regs.

If petitioner employed section 38 property to construct its own capital assets and all the depreciation on that section 38 property were construction related in a given

taxable year, then all that depreciation would have to be capitalized and could not be allowed as a deduction. *Commissioner* v. *Idaho Power Co.*, 418 U.S. 1 (1974). The obvious conclusion is that the section 38 property used in the construction would cease to qualify as section 38 property. Section 47(a)(1) would then require a recapture of credit according to the property's actual term of service as section 38 property. However, the basis of the constructed capital asset would include the construction-related depreciation. If the constructed capital asset qualified as new section 38 property, then its basis, including the capitalized depreciation, would be used in computing qualified investment according to its estimated useful life.

The respondent's regulations take different tack. Regulations section 1.48-1(b)(4)[13] provides that for purposes of qualifying as section 38 property, any property with respect to which a depreciation deduction is not allowed in a given taxable year because it must be capitalized, nevertheless shall be treated as property on which a depreciation deduction is allowable in the current year. Under this regulation, no investment credit on section 38

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13. Sec. 1.48-1(b)(4), Income Tax Regs.:

If depreciation sustained on property is not an allowable deduction for the taxable year but is added to the basis of property being constructed, reconstructed, or erected by the taxpayer for purposes of subparagraph (1) of this paragraph a deduction for depreciation shall be treated as allowable for the taxable year with respect to the property on which depreciation is sustained. Thus, if $1,000 of depreciation sustained with respect to property no. 1, which is placed in service in 1964 by taxpayer A, is not allowable to A as a deduction for 1964 but is added to the basis of property being constructed by A (property no. 2), for purposes of subparagraph (1) of this paragraph a deduction for depreciation shall be treated as allowable to A for 1964 with respect to property no. 1. However, the $1,000 amount is not included in the basis of property no. 2 for purposes of determining A's qualified investment with respect to property no. 2. See paragraph (c) (1) of section 1.46-3.

property used solely in the construction of the taxpayer's own capital assets is recaptured.

Though it is less than conceptually correct, this regulation is eminently reasonable and consistent with the statute. Without such treatment, gross abuses would be allowed to flourish. As long as some depreciation would be allowable, the property would continue to qualify as section 38 property. For example, taxpayers could use section 38 property for construction of their own capital assets 11 months a year and for other purposes during the 12th month. Because some depreciation would be allowable, there would be no recapture of credit. Moreover, the construction-related depreciation capitalized in the basis of the constructed asset would be eligible for the section 38 credit, assuming the constructed asset qualified. Section 1.46-3(c)(1) of the regulations is designed specifically to prevent this abuse, and to that extent is reasonable and consistent with the statute's purpose.[14]

However, regulations section 1.46-3(c)(1) goes too far. This regulation prohibits the petitioner from including in the basis of constructed section 38 property, for purposes of determining qualified investment, all construction-related depreciation with respect to any property.

We think that construction-related depreciation with respect to assets with useful lives of less than 4 years or to assets acquired prior to January 1, 1962, should be properly included in the basis of constructed section

14. We are mindful of the case where sec. 38 property on which the investment credit has been allowed is used to construct sec. 38 property only during part of the year for valid business reasons. In such a case the statute does not exclude the applicable capitalized depreciation from the basis of the constructed sec. 38 property *for purposes of determining qualified investment.* However, we think that the potential for abuse is great enough to support the respondent's regulation regarding sec. 38 property on which the investment credit has been allowed.

38 property for purposes of determining qualified investment. No investment credit has been allowed with respect to these assets and, therefore, the abuse-prevention scheme of regulations sections 1.46-3(c)(1) and 1.48-1(b)(1) and (4) is inapplicable.

Although neither party has called it to our attention, we note that the legislative history of new section 46(d), added to the Code by the Tax Reduction Act of 1975, Pub. L. 94-12 (Mar. 29, 1975), contains language at odds with the legislative history of the investment credit as enacted by the Revenue Act of 1962 and with our holding herein. New section 46(d) introduces to the investment credit provisions the term "qualified progress expenditures" by which a taxpayer may, at his election, increase his qualified investment by these "expenditures" as defined by section 46(d)(3).

In partial explanation of these "expenditures," the House and Senate committee reports accompanying the Tax Reduction Act of 1975 contain identical language as follows:

> qualified progress expenditures would not include any depreciation sustained with respect to other property (machinery, equipment, etc.) used in the construction of new section 38 property (because such depreciation is not part of the basis for purposes of section 38), * * * [H. Rept. No. 94-19, 94th Cong., 1st Sess. 38 (1975); S. Rept. No. 94-36, 94th Cong., 1st Sess. 46 (1975).]

We think the parenthetical remarks quoted above deserve little weight. As the Supreme Court has said, "the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one." *United States v. Price*, 361 U.S. 304, 313 (1960); see also *Waterman*

Steamship Corp. v. *United States,* 381 U.S. 252, 268, 269 (1965); *United States* v. *United Mine Workers,* 330 U.S. 258, 281-284 (1947); cf. *Biddle* v. *Commissioner,* 302 U.S. 573, 582 (1938). However, we have not altogether disregarded the statements, and we have treated them as "a secondarily authoritative expression of expert opinion." *Bobsee Corp.* v. *United States,* 411 F. 2d 231, 237 n. 18 (5th Cir. 1969).

We note that the statute itself does not change the definition of "new section 38 property" contained in section 48(b), discussed *supra,* nor does it change the meaning of "basis" as used in section 46(c)(1)(A) concerning qualified investment. What the statute does do is liberalize the definition of "qualified investment," at the taxpayer's election, with respect to constructed new section 38 property. Certain amounts invested in constructed new section 38 property now may be added to qualified investment prior to the placement of the property in service. Compare sec. 46(c)(1)(A) with sec. 46(d)(4). Section 46(d) is effective for taxable years ending after December 31, 1974.

As we have pointed out, the legislative history of the investment credit at the time of its enactment states without reservation that the basis of new section 38 property is to be determined under the general rules for determining basis, i.e., cost. See n. 7 *supra,* and accompanying text. We think this language must prevail to the extent a conflict exists between it and the parenthetical remarks in the House and Senate committee reports on new section 46(d) because it evolved out of the deliberations and debates which gave birth to the whole statutory scheme of the investment credit. Moreover, the use of "basis" in the definition of new section 38 property (sec. 48(b)) and in the definition of "qualified investment" (sec. 46(c)

(1)(A)) has remained unchanged since those sections were first enacted by the Revenue Act of 1962.

When the investment credit was "restored" (Revenue Act of 1971, 85 Stat. 497) after it had been terminated (Tax Reform Act of 1969, 83 Stat. 487), Congress adopted the prior statutory scheme intact with three major changes unrelated to the issue here. H. Rept. No. 92-533, 92d Cong., 1st Sess. 24 (1971); S. Rept. No. 92-437, 92d Cong., 1st Sess. 17 (1971). ((1) The useful life brackets for determining qualified investment under section 46(c)(2) were each shortened by one year. (2) Restrictions were placed on the eligibility of foreign-produced machinery and equipment for the credit. (3) Public utility property was made eligible for a 4-percent rather than a 3-percent credit.) Thus, in "restoring" the investment credit, Congress relied substantially and predominantly on the thought and examination given to the investment credit provisions by its predecessor. We see no good reason why we should not do likewise.

It should also be noted that because the investment credit provisions were enacted expressly to encourage investment in and modernization of facilities and equipment by reducing the net cost of acquiring assets, this Court and others have held that the investment credit provisions are to be liberally construed. *Northville Dock Corp.,* 52 T.C. 68 (1969); *Robert E. Catron,* 50 T.C. 306 (1968); *Minot Federal Savings & Loan Assn.* v. *United States,* 435 F. 2d 1368 (8th Cir. 1970); *Norfolk Shipbuilding & Drydock Corp.* v. *United States,* 321 F. Supp. 222 (E.D. Va. 1971).

In view of the foregoing analysis and with due regard to the weighty presumption of its validity, we are compelled to hold that portion of the regulations quoted in

the footnote[15] to be unreasonable and plainly inconsistent with the statute, but only to the limited extent that it excludes from basis for purposes of determining qualified investment in new section 38 property, the construction-related depreciation attributable to property on which no investment credit has been allowed.

To the extent that the regulation is concerned with construction-related depreciation attributable to section 38 property on which an investment credit has been allowed, it is valid.

Because of concessions,

Decision will be entered under Rule 155.

Reviewed by the Court.

WILBUR, *J.*, concurring: This case concerns the application of the investment credit provisions to self-constructed property whereby a taxpayer uses property A to self-construct property B. Even though property A and property B meet the statutory definition of qualified property, the regulations deny a "double credit" by requiring that the credit be taken on property A and that the basis of property A be excluded from property B for purposes of computing the investment credit on property B. While hardly free from doubt, the regulations are not plainly inconsistent with the statute.[1]

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15. Sec. 1.46-3(c)(1), Income Tax Regs.:

However, for purposes of determining qualified investment, the basis of new section 38 property constructed, reconstructed, or erected by the taxpayer shall not include any depreciation sustained with respect to *any* other property used in the construction, reconstruction, or erection of such new section 38 property. [Emphasis supplied.]

1. If property B is purchased, the taxpayer will get the full credit on property B. The purchase price of property B in a

(*Continued on following page*)

The regulation in question (sec. 1.46-3(c)(1)) provides:

> (c) *Basis or cost.* (1) The basis of any new section 38 property shall be determined in accordance with the general rules for determining the basis of property. Thus, the basis of property would generally be its cost (see section 1012), unreduced by the adjust-

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Footnote continued—

competitive environment will reflect a passthrough of the investment credit on property A that the manufacturer has used in manufacturing property B. If the manufacturer's markup is ignored, a taxpayer may, by purchasing rather than self-constructing property B, derive the benefit of the credit on both property A and B that he is denied when self-constructing. Additionally, due to the manufacturer's markup, the cost of the tax credits to the Federal Government when the property is purchased may exceed the cost of the credits when the property is self-constructed, although the macroeconomic effects (ignoring those associated with the manufacturer's distribution) would be essentially the same. Thus, it can be argued that the purpose of the credit, as well as the intent to treat those self-constructing property the same as those purchasing property, require that both property A and B qualify for the credit.

However, as pointed out *infra*, the regulations have been in effect for more than a decade during which Congress has suspended, restored, repealed, reenacted, and substantially broadened the credit. Earlier this year the regulations were specifically considered by Congress, and determined to be the rule the statute contemplates. See sec. 46(d), added by Pub. L. 94-12 (Mar. 29, 1975). See also H. Rept. No. 94-19, to accompany H.R. 2166 (Pub. L. 94-12), 94th Cong., 1st Sess. 38 (1975); S. Rept. No. 94-36, to accompany H.R. 2166 (Pub. L. 94-12), 94th Cong., 1st Sess. 46 (1975). Additionally, these arguments can also be made with regard to depreciation, and yet it is clear an individual self-constructing assets can claim depreciation only on the asset he constructs. *Commissioner* v. *Idaho Power Co.*, 418 U.S. 1 (1974). Admittedly, the method the regulations employ to deny a double credit differs from the method used in reference to depreciation under *Idaho Power*, and this can produce some anomalies. (For example, property A may have a short useful life qualifying for only one-third of the credit, while property B has a longer useful life qualifying for the full credit; only the partial credit for property A is allowed rather than the full credit for property B). But this difference is understandable, since the entire investment credit is claimed in the year an asset is placed in service (rather than over its useful life as in the case of depreciation), and the taxpayer cannot defer claiming the credit because he may later use the asset in self-constructing other property.

> ment to basis provided by section 48(g)(1) with respect to property placed in service before January 1, 1964, and any other adjustment to basis, such as that for depreciation, and would include all items properly included by the taxpayer in the depreciable basis of the property, such as installation and freight costs. *However, for purposes of determining qualified investment, the basis of new section 38 property constructed, reconstructed, or erected by the taxpayer shall not include any depreciation sustained with respect to any other property used in the construction, reconstruction or erection of such new section 38 property.* (*See paragraph* (b)(4) *of section 1.48-1*) * * * [Emphasis added.]

The majority broadly construes this regulation to exclude from the basis of self-constructed property (property B) *any* depreciation on other property (property A) used in the construction process. When the other property (property A) used in self-constructing assets does not qualify for the investment credit, this interpretation of the regulation denies any credit, and the emphasized portion of the regulation is therefore declared invalid by the majority.

If this interpretation of the regulation is correct, the regulation is invalid. However, the regulation can and should be construed in pari materia with related provisions of the regulations to achieve the same result without declaring it invalid. Immediately following the sentence the majority invalidates is a specific reference to section 1.48-1 (b)(4), Income Tax Regs. Section 1.48-1 deals in its entirety with the definition of "section 38 property," that is, property qualifying for the investment credit. Section 1.48-1(a), in providing a general definition of qualifying property, states that it must be property on which deprecia-

tion is allowable. Subsection 1.48-1(b) dealing with the issue of when property otherwise within the definition of qualifying property is property on which depreciation is allowable, states:

> (b) *Depreciation allowable.* (1) Property is not section 38 property unless a deduction for depreciation (or amortization in lieu of depreciation) with respect to such property is allowable to the taxpayer for the taxable year. A deduction for depreciation is allowable if the property is of a character subject to the allowance for depreciation under section 167 and the basis (or cost) of the property is recovered through a method of depreciation, including, for example, the unit of production method and the retirement method as well as methods of depreciation which measure the life of the property in terms of years. If property is placed in service (within the meaning of paragraph (d) of section 1.46-3) in a trade or business (or in the production of income), but under the taxpayer's depreciation practice the period for depreciation with respect to such property begins in a taxable year subsequent to the taxable year in which such property is placed in service, then a deduction for depreciation shall be treated as allowable with respect to such property in the earlier taxable year (or years). Thus, for example, if a machine is placed in service in a trade or business in 1963, but the period for depreciation with respect to such machine begins in 1964, because the taxpayer uses an averaging convention (see section 1.167(a)-10) in computing depreciation, then, *for purposes of determining whether the machine qualifies as section 38 property,* a deduction for depreciation shall be treated as allowable in 1963.
>
> * * *

(4) If depreciation sustained on property is not an allowable deduction for the taxable year but is added to the basis of property being constructed, reconstructed, or erected by the taxpayer, *for purposes of subparagraph (1) of this paragraph* a deduction for depreciation shall be treated as allowable for the taxable year with respect to the property on which depreciation is sustained. Thus, if $1,000 of depreciation sustained with respect to property no. 1, which is placed in service in 1964 by taxpayer A, is not allowable to A as a deduction for 1964 but is added to the basis of property being constructed by A (property no. 2) for purposes of subparagraph (1) of this paragraph a deduction for depreciation shall be treated as allowable to A for 1964 with respect to property no. 1. However, the $1,000 amount is not included in the basis of property no. 2 for purposes of determining A's qualified investment with respect to property no. 2. *See paragraph (c)(1) of section 1.46-3.*

[Emphasis added.]

Paragraph (b)(1) makes it clear that, while depreciation may not be allowable during the year property is placed in service due to a particular depreciation convention, a deduction for depreciation shall be considered as allowable *for purposes of determining whether the machine qualifies as section 38 property.* Paragraph (b)(4) also makes it clear that, while depreciation on property used to self-construct another asset must be carried over to the self-constructed asset, the property used in the construction process will be deemed depreciable *for purposes of subparagraph (1) of this paragraph.* Both paragraphs assume and deal with a situation where the property used in the construction process is itself section 38 property, rather than nonqualifying property as the majority assumes.

Regulations section 1.48-1(b)(4) and section 1.46-3(c)(1) (invalidated in part by the majority) contain reciprocal cross references. Furthermore, since they both deal with the same matter, they must be construed in pari materia, as it is indeed clear they were intended to be construed. By construing these regulations together, it is clear they were intended only to disallow a double credit and advise the taxpayer which property to claim the credit on rather than to deny any credit at all. Since Treasury regulations constitute contemporaneous constructions by those charged with the administration of the statutes, they must be sustained unless "*plainly* inconsistent" with the statute. This is particularly true where the Commissioner's regulatory authority derives not only from the general rule-making authority granted in section 7805, but also under a specific mandate contained in the statutory provisions being construed. See *William F. Sanford*, 50 T.C. 823, 832 (1968), affd. per curiam 412 F. 2d 201 (2d Cir. 1969), cert. denied 396 U.S. 841 (1969). Properly construed, the regulation is not plainly inconsistent with the statute.

The majority apparently feels that its interpretation of the regulation is not only clear, but clearly inconsistent with the statute. But if it is clear to the majority, it must have been clear to Congress; and Congress has in the sum total of its actions through the years, clearly indicated that the regulation incorporates the rule of the statute.

Congress has reenacted and expanded provisions of the investment credit with specific knowledge of the construction placed upon the statute by the regulations. The investment credit was added by the Revenue Act of 1962 and amended in the Revenue Act of 1964. The regulations in question were promulgated by TD 6731 on

May 7, 1964, and have not been amended since that time. During the 11 years those regulations have been in effect, the investment credit was suspended,[2] restored,[3] repealed,[4] reenacted,[5] and substantially broadened.[6] All of these congressional actions required Congress to deal with basis problems, and no change in the applicable statutory language has occurred during the entire 11-year period the regulations have been on the books.

While this alone might not be enough, in the last legislative action taken by Congress (Pub. L. 94-12 (Mar. 29, 1975)), the rule provided by the regulation was specifically commented upon (in a virtually verbatim restatement), approved, and incorporated in the statute. (Sec. 46(d)(3)). In greatly expanding the investment credit, Congress added provisions to the statute making the credit applicable to certain work in progress, even though the property has not yet been "placed in service." In doing so, the credit was made available for "qualified progress expenditures," defined by the statute (to the extent here relevant) as follows:

> (3) Qualified Progress Expenditures Defined—For purposes of this subsection—
>
> > (A) Self-Constructed Property.—In the case of any self-constructed property, the term "qualified progress expenditures" means the amount which, *for purposes of this subpart, is, properly chargeable (during such taxable year) to capital account* with respect to such property. [Emphasis added.]

2. Pub. L. 89-800 (Nov. 8, 1966).
3. Pub. L. 90-26 (June 13, 1967).
4. Pub. L. 91-172 (Dec. 30, 1969).
5. Pub. L. 92-178 (Dec. 10, 1971).
6. Pub. L. 94-12 (Mar. 29, 1975).

In explaining what is meant by this statutory language, the committee reports contain the following comment:

> In the case of self-constructed property (i.e., property where it is reasonable to believe that the taxpayer will bear more than half of the construction costs directly) "qualified progress expenditures" will generally equal the costs incurred by the taxpayer which are *properly chargeable to capital account in connection with that property (for purposes of the investment credit). Thus, qualified progress expenditures would not include any depreciation sustained with respect to other property (machinery, equipment, etc.) used in the construction of new section 38 property (because such depreciation is not part of the basis for purposes of section 38)*, nor generally would it include the adjusted basis of reconstructed property at the time the reconstruction is commenced. [H. Rept. 94-19, 94th Cong., 1st Sess. 38 (1975). (Emphasis added.) See also S. Rept. 94-36, 94th Cong., 1st Sess. 46 (1975) (substantially identical language).]

It is therefore clear that Congress has specifically considered the language of the regulation, and declared it is the rule the statute contemplates. Moreover, the language in section 46(d) (when considered in the light of the legislative history) actually incorporates the rule of the regulation.[7]

7. The majority repudiates all of this legislative history on the basis of *United States* v. *Price*, 361 U.S. 304, 313 (1960), and in this they err. In 1971 Congress amended the definition of property qualifying for the investment credit to include motion picture film, indicating in the legislative history that the prior law was intended to cover film. The Government, citing *Price*, argued that the legislative history of a subsequent Congress was of little value in interpreting a law enacted by a prior Congress. The Ninth Circuit firmly rejected this argument in the following words:

(Continued on following page)

My quarrel with the majority arises from their willingness to disregard more than a decade of congressional actions subsequent to the promulgation of the regulations in question as well as their implicit assumption that Congress adopted (for purposes of qualifying progress expenditures under new section 46(d)), an unambiguous rule clearly inconsistent with the statute as it then existed.[8] I believe the regulation is ambiguous, and should be read to preclude only a double credit and not to deny any credit at all on certain property, and that Congress in fact understood the rule in this manner. In discussing the rule of the regulation in issue, Congress noted that

---

Footnote continued—

"The government urges that this legislative history is irrelevant because the 1971 Act changed prior law, or at least that the history is entitled to little weight because 'the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one.' United States v. Price, 361 U.S. 304, 313, 80 S. Ct. 326, 332, 4 L. Ed. 2d 334 (1960). However, although the 1971 re-enactment of the investment credit did change prior law in several ways, *see, e.g.*, Revenue Act of 1971, Pub. L. No. 92-178, section 104(c), 85 Stat. 497, 501, it did not change the phrase 'tangible personal property' as used in the 1962 Act, Int. Rev. Code of 1954, section 48(a)(1)(A). And, while subsequent legislative history normally is not of controlling weight, it should not be ignored when it is clearly relevant.

"In this case we give subsequent legislative history special weight, because the inferences flow not from Congressional action or inaction on amendatory legislation, but from explicit Congressional statements of the meaning of a phrase which was unchanged during the period in question. * * * [*Walt Disney Productions* v. *United States,* 480 F.2d 66, 68, 69 (9th Cir. 1973). Citations omitted. Emphasis added.]"

The case before us is clearly within this rationale.

8. Apparently, under the majority opinion the plain rule of the invalidated regulation which Congress adopted will apply to the new progress expenditure provisions of the investment credit, but not to provisions enacted by previous Congresses. This seems anomalous since the statute and legislative history made it clear that the new provisions were carefully integrated with existing provisions, and yet two separate rules regarding the basis of self-constructed assets will apply. See H. Rept. 94-19, *supra* at 40.

the basis of self-constructed property excludes "any depreciation sustained with respect to other property (*machinery, equipment, etc.*) used in the construction of new section 38 property (because such depreciation is not part of the basis for purposes of section 38)." H. Rept. 94-19, *supra* at 38 (emphasis added). It is hard to believe that Congress, in referring to "machinery and equipment," did not have in mind items themselves qualifying for the investment credit. When Congress used the terms machinery and equipment in other provisions of the investment credit, it contemplated qualifying property. See secs. 48(h)(4)(A) and 48(h)(6).

Additionally, in liberalizing the statute earlier this year, Congress followed the historical practice of treating those who self-construct equipment and facilities on the same basis as those who purchase these items from others. If the majority is correct, and the rule of the regulation Congress referred to and adopted excludes all depreciation of any kind from the basis of self-constructed property, it would be economically disadvantageous to self-construct capital intensive items. This would be clearly inconsistent with the parity of treatment Congress intended, particularly in view of the nature of the assets qualifying for the investment credit.

The majority broadly construes the regulation in question, and then invalidates the regulation as so construed. A narrow construction of the regulation, which accords with the statutory language and underlying purpose, as well as the legislative history, would obviate the problems created in invalidating one part of an interrelated set of regulations. The investment credit provisions are an interrelated set of rules developed over the last 13 years to achieve economic objectives rather than equity in the area of cost recovery. The provisions have been enacted,

amended, suspended, restored, repealed, reenacted, and greatly expanded over this 13-year period. Necessarily, legislative action through the years has tied into language added to the Code in earlier years and developed a series of complex and integrated rules that require the interpretation of the investment credit provisions as a whole rather than in fragmented parts. It simply will not work any other way and it is inconsistent with the way Congress has developed the provisions through the years. There is simply no need or cause to invalidate the regulation, which has apparently worked reasonably well through the years and has met with the approval of Congress.

RAUM, TANNENWALD, STERRETT, and QUEALY, *JJ.*, agree with this concurring opinion.

67 UNITED STATES TAX COURT REPORTS

UNITED TELECOMMUNICATIONS, INC. (FORMERLY UNITED UTILITIES INCORPORATED), PETITIONER V. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 7866-72. Filed January 31, 1977.

Held, for purposes of determining qualified investment pursuant to sec. 46(c)(1)(A) on which the new sec. 38 credit against tax is calculated, the basis of the self-constructed new sec. 38 property does not include depreciation sustained with respect to construction-related assets having useful lives of at least 4, but less than 8, years.

William H. Curtis, George F. Crawford, and *Allan W. Stopperan,* for the petitioner.

Joe K. Gordon, for the respondent.

SUPPLEMENTAL OPINION

FORRESTER, *Judge*: On November 10, 1975, we filed our Findings of Fact and Opinion in the instant case (65 T.C. 278), which held that petitioner[1] was entitled to include in the basis of self-constructed telephone and powerplant properties that qualify as new section 38 property the capitalized depreciation of property used in its construction on which no investment credit had been allowed.

The problem with which we were faced in our prior opinion is outlined in detail therein. The following brief

1. As in our prior opinion, we will continue to refer only to petitioner though it was actually petitioner's subsidiaries that constructed the new sec. 38 property.

recapitulation is necessary, however, in order to understand more easily the issue now before us: The Supreme Court has held that depreciation on capital assets used in the construction of other capital assets must be treated for tax purposes as a cost of acquiring the constructed asset and, therefore, such depreciation must be capitalized as part of the basis of the constructed asset rather than taken as a current deduction. *Commissioner* v. *Idaho Power Co.*, 418 U.S. 1 (1974). Section 48(a)(1) defines "section 38 property," inter alia, as property "with respect to which depreciation* * * is allowable." A logical interplay of *Idaho Power* and section 48(a)(1) would mean that once a capital asset was used in the construction of another capital asset,[2] a depreciation deduction with respect to the construction-related asset would no longer be allowable (because it must instead be capitalized), and the construction-related asset would at that point cease to qualify as section 38 property. Once the asset no longer qualifies as section 38 property, section 47[3] would become applicable, and a part or all of the investment credit taken on the construction-related asset would be recaptured.

2. Hereinafter, these assets will be referred to, respectively, as the "construction-related asset" and the "constructed asset."

3. SEC. 47. CERTAIN DISPOSITIONS, ETC., OF SECTION 38 PROPERTY.

(a) GENERAL RULE.—Under regulations prescribed by the secretary or his delegate—

(1) EARLY DISPOSITION, ETC.—If during any taxable year any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the useful life which was taken into account in computing the credit under section 38, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from substituting, in determining qualified investment, for such useful life the period beginning with the time such property was placed in service by the taxpayer and ending with the time such property ceased to be section 38 property.

Respondent's regulations, however, do not permit the tax consequences to proceed in this fashion. Section 1.48-1(b)(4), Income Tax Regs., in defining "depreciation allowable," provides that where depreciation on a construction-related asset is not allowed as a deduction but must be capitalized as part of the basis of the constructed asset, a deduction for depreciation shall be *treated* as allowable for the taxable year with respect to the property on which the depreciation is sustained. Thus, because respondent treats the deduction as allowable for the taxable year, the asset continues to qualify as a section 38 asset for that year and no recapture is effected. Respondent's generosity is tempered, however, by section 1.46-3(c)(1), Income Tax Regs., which provides, in part, as follows:

> However, for purposes of determining qualified investment, the basis of new section 38 property constructed, reconstructed, or erected by the taxpayer shall not include any depreciation sustained with respect to any other property used in the construction, reconstruction, or erection, of such new section 38 property. * * *

In our prior opinion, we recognized that the regulatory scheme of sections 1.46-3(c)(1) and 1.48-1(b)(4) was at odds with the normal interaction of *Idaho Power* and the investment credit statutory provisions; nevertheless, we held that such an approach was reasonable and consistent with the statutes' purpose in that it served to prevent manipulations by taxpayers whereby they could receive, in essence, a double investment credit. 65 T.C. at 286.

However, we held the above-quoted portion of section 1.46-3(c)(1), Income Tax Regs., to be invalid to the extent that, in determining the qualified investment in new section 38 constructed property, it excluded from that prop-

erty's basis the capitalized depreciation on construction-related assets on which *no* investment credit had been previously allowed. Because no investment credit had been allowed with respect to these assets, we found the regulatory abuse-prevention scheme to be inapplicable. 65 T.C. at 287.

The issue now before us arises out of petitioner's objection to respondent's deficiency computation submitted to this Court under Rule 155, Tax Court Rules of Practice and Procedure.

In order to understand the present controversy, it is first necessary to examine the manner in which the actual amount of the allowable investment credit is computed. For the taxable years before us (1964 and 1965) section 46(a) allowed an investment credit equal to 7 percent of a taxpayer's "qualified investment" in section 38 property. For these same years, section 46(c) defined "qualified investment" in new section 38 property as follows:

(c) QUALIFIED INVESTMENT.—

(1) IN GENERAL.—For purposes of this subpart, the term "qualified investment" means, with respect to any taxable year * * *

(A) the applicable percentage of the basis of each new section 38 property (as defined in section 48(b)) placed in service by the taxpayer during such taxable year, * * *

* * *

(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the applicable percentage for any property shall be determined under the following table:

If the useful life is—	*The applicable percentage is—*
4 years or more but less than 6 years	33⅓
6 years or more but less than 8 years	66⅔
8 years or more	100

In making his Rule 155 computation, respondent proceeded as follows: In computing petitioner's "qualified investment" in new section 38 constructed property, he allowed all of the depreciation on construction-related property, with respect to which no investment credit had been allowed, to be capitalized as part of the constructed property's basis. However, if an investment credit had been allowed with respect to any construction-related property, respondent did not allow any depreciation with respect to such property to be so capitalized.

Petitioner's sole objection to respondent's Rule 155 computation is directed toward those particular construction-related assets with useful lives of at least 4, but less than 8 years. It contends that because its allowable "qualified investment" in such assets is less than 100 percent of basis, it should be allowed to capitalize the depreciation in proportion to that part of the basis not permitted to be taken into account in computing "qualified investment." For example, if a truck used in the construction of a new section 38 asset has a useful life of only 5 years, its "qualified investment" in the truck would be only one-third of its basis. Accordingly, petitioner argues that two-thirds of the truck's depreciation should be permitted to

be capitalized as part of the basis of the constructed asset. We do not agree.

In our prior opinion, we carefully considered and, for the most part, found valid the regulatory scheme of sections 1.46-3(c)(1) and 1.48-1(b)(4). In essence, the interplay of these two sections of the regulations effects a trade-off whereby respondent, by treating the depreciation sustained on the construction-related asset as "allowable," foregoes recapture of the investment credit taken on such asset but, in return, disallows the capitalization of the depreciation sustained with respect to the asset. Where *no* investment credit had been previously allowed with respect to the construction-related asset, however, that portion of the regulations which we found invalid would have still disallowed the capitalization of the depreciation. In such a situation there would be, in reality, no trade-off: respondent's disallowance of the capitalized depreciation would not be balanced by the reciprocal forbearance of recapture since, in such a case, there would be no investment credit to be recaptured. However, where an investment credit had been previously taken with respect to an asset, albeit an asset with a useful life of at least 4 but less than 8 years, then there is substance to respondent's trade-off and, in such a case, we think his regulatory scheme should be permitted to function as designed.

We fully realize that this balance may at times be imperfect and may not result in perfect equity in all cases.[4]

4. Any economic disparities will by no means always work to respondent's benefit. We can imagine any number of factual situations in which the amount of the investment credit that otherwise would be recaptured would exceed the potential benefit resulting from increasing the taxpayer's qualified investment in the constructed asset by the amount of the capitalized depreciation.

Nevertheless, this is the regulatory path respondent has chosen to follow and one which we have found to be reasonable and consistent with the statute from an abuse-prevention standpoint. To reach the result proffered by petitioner would necessitate our engaging in a detailed rewriting of respondent's regulations. This we would not do in our prior opinion, and we will not do so here.

Decision will be entered in accord with respondent's computation.

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 77-1392

UNITED TELECOMMUNICATIONS, INC.
(formerly United Utilities, Incorporated),
Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

Appeal from the Decision of the United States Tax Court

(Filed December 29, 1978)

William H. Curtis, Kansas City, Missouri (George F. Crawford and Allan W. Stopperan, Kansas City, Missouri, on the brief), for Appellant.

Stanley S. Shaw, Jr., Tax Division, Department of Justice, Washington, D.C. (M. Carr Ferguson, Assistant Attorney General, and Gilbert E. Andrews, on the brief), for Appellee.

Before McWILLIAMS, BARRETT and DOYLE, Circuit Judges.

DOYLE, Circuit Judge.

United Telecommunications, Inc. here seeks review of a decision of the Tax Court ruling against it in a dispute

in which the Commissioner acted in accordance with Treasury Reg. 1.46-3(c)(1). This provides in pertinent part:

> . . . the basis of new section 38 property constructed, reconstructed, or erected by the taxpayer shall not include any depreciation sustained with respect to any other property used in the construction, reconstruction, or erection of such new section 38 property.

The taxpayer-petitioner's legal position here, as it was before the Tax Court and the Commissioner, is that the above-quoted regulation is invalid, the consequence of which would be that the exclusion by the Commissioner and the Tax Court of capitalized depreciation from taxpayer's investment credit basis was not justified. We disagree with taxpayer's contention. We affirm the Tax Court.

The facts were for the most part stipulated. The taxpayer, a Kansas corporation, has a number of operating subsidiaries incorporated in various states. Consolidated returns were filed by taxpayer in conjunction with the subsidiaries in 1964 and 1965, which are the taxable years here in question.

The subsidiaries use their own equipment to construct new property. Under the applicable state and federal regulatory provisions, they are required for financial accounting to capitalize the depreciation of this construction equipment as part of the cost basis of the newly constructed property. It became clear after the Supreme Court's decision in Commissioner v. Idaho Power Co., 418 U.S. 1 (1974), that in order to compute depreciation for tax purposes, the depreciation on the construction equipment had to be capitalized and recovered as part of the cost of the constructed property.

The taxpayer did capitalize the depreciation on the construction equipment as part of the basis of the constructed property and used that basis in computing the investment tax credit. The taxpayer also claimed investment tax credit on the cost of the construction equipment when it qualified. The result was that the taxpayer frequently claimed a double credit for the same expenditure, once for construction equipment, and also as allocated cost of the constructed property.

The Commissioner disallowed this attempt to obtain a double investment tax credit as being in direct conflict with the regulation quoted above. The taxpayer filed a petition in the Tax Court to contest the deficiencies which were ruled to exist by the Commissioner.

The Tax Court also refused to permit the double credit. *See* United Telecommunications, Inc. v. Commissioner, 65 T.C. 278 (1975). The majority upheld the regulations in question, Treas. Reg. §§ 1.46-3(c)(1) and 1.48-1(b)(4), to the extent that they were applicable in this case and prohibited the taxpayer, when computing the investment tax credit, from increasing the basis of the constructed property by cost allocated from the construction equipment on which the taxpayer had already taken an investment tax credit. Treas. Reg. § 1.46-3(c)(1) was partly invalidated by the majority, but only to the extent that it prevented the cost of the constructed property from including any depreciation attributable to construction equipment when there had been no investment tax credit allowed on the equipment.

Five Tax Court judges concurred in the result. Their view was that the regulation should have been fully upheld. Their view was, also, that the two regulations should have been read together and that the ambiguities should have been construed so as to hold the regulations valid.

The Commissioner had computed deficiencies of $5,-963.21 for 1964 and $83,575.92 for 1965.[1] The taxpayer's approach to the deficiencies was to take an additional credit when the construction equipment had not received the maximum amount of credit. Where the construction equipment had a useful life of less than eight years, the taxpayer contended that part of the investment in such equipment failed to qualify for the credit. It then argued that the investment portion which failed to qualify should have been considered as part of the capitalized cost of the constructed property, whereby credit available on the construction of the property would be increased.[2]

The taxpayer's argument was rejected by the Tax Court in a supplemental opinion, which upheld the Commissioner's computation. *See* United Telecommunications, Inc. v. Commissioner, 67 T.C. 760 (1977). The regulations were found in this connection to be valid and to prohibit the taxpayer's method of computation.

The claim of the taxpayer here is that the regulation (Treas. Reg. § 1.46-3(c)(1)) is invalid because it excluded capitalized depreciation from the basis of constructed property, which is used to calculate the investment tax credit on the constructed property.

Exclusion of the capitalized depreciation from basis is said to be in conflict with the intention of Congress in using the word "basis" in § 46(c)(1)(A). This provides

1. In addition to the investment tax credit, the deficiencies include items which were settled by the parties.

2. For example, if all the cost of the construction equipment A (useful life of four years) were to be capitalized in the constructed property B (useful life of eight years), the taxpayer argues that one-third of the cost of property A should be eligible for investment tax credit on property A and the remaining two-thirds of the cost of property A should be included in the cost of property B, which is used to compute the credit on property B.

that "qualified investment" (which amount is used to calculate the investment tax credit) is the aggregate of "the applicable percentage of the basis of each new section 38 property . . ." The term "basis," it is further argued, is here used in its ordinary and customary sense, which includes capitalized depreciation. A further argument is that the basis of a self-constructed asset, for depreciation purposes, necessarily includes the capitalized depreciation from the construction equipment. Commissioner v. Idaho Power Co., 418 U.S. 1 (1974).

Therefore, the thrust of the taxpayer's argument is allowance of a double investment tax credit on the same cost outlay, since it allows the credit to be taken on the construction equipment and again on the cost of that equipment which has been allocated as capitalized depreciation to the cost of the constructed property. The result is that both the construction equipment and the constructed property are treated as § 38 property and hence eligible for investment tax credit.

The Commissioner's position is that since the double investment tax credit could not be claimed, the regulations should be held valid to the extent that they prohibited such a double credit. Where both construction equipment and constructed property qualified for the credit, the Tax Court upheld the regulation and in doing so forced the taxpayer to compute the credit on the construction equipment. On the other hand, the taxpayer was allowed to include capitalized depreciation on construction equipment which is ineligible for the credit as part of the cost of the constructed property used to compute the credit on the constructed property. Therefore, if the construction equipment failed to qualify for the credit, the taxpayer could still realize the credit by capitalizing the cost of the construction equipment in the cost of constructed property

which qualified. The majority of the Tax Court invalidated the regulation to the extent that it would deny any credit in this latter situation.

The Commissioner maintains that insofar as the regulations forbid double investment credit, they are reasonable and consistent with the statute and therefore it is proper that they be upheld. The Commissioner further points out that the regulations are consistent with his broad authority to carry out statutory purposes through regulations and his specific authority to promulgate regulations in the investment tax credit area under § 38(b).

Even if a double credit is prohibited, the taxpayer argues, he should be allowed to obtain the maximum credit for such expenditure where the constructed property has a longer useful life than the construction equipment. The Tax Court held that it is not permissible to have an investment tax credit computed in part on the construction equipment and part on the constructed property, whereby the taxpayer received the benefit of the longer useful life of the constructed property. The Commissioner's objection is that such a computation is not justified by the statute or the regulation.

The stated purpose of the Revenue Act of 1962 was to encourage modernization and expansion of productive facilities, stimulate economic growth, increase job opportunities, and improve the balance of payments.[3] The effect of the investment tax credit was to reduce federal income taxes which Congress hoped would result in an increase in capital investment.

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3. H. Conf. Rep. No. 2508, 87th Cong., 2d Sess., *reprinted in* [1962] U.S. Code Cong. & Ad. News 3732, 3734; S. Rep. No. 1881, 87th Cong., 2d Sess., *reprinted in* [1962] U.S. Code Cong. & Ad. News 3297, 3313-14; H.R. Rep. No. 2518, 87th Cong., 2d Sess., 1962-3 C.B. 405, 411.

Section 38 allowed a credit for investment in certain depreciable property called "section 38 property." The amount of this was equal to 7% of the taxpayer's "qualified investment" as that term was defined in § 46(a)(1). As a result of the taxpayer here being a public utility, the credit is limited to 3% by § 46(c)(3), which provides that for public utilities the amount of the qualified investment is 3/7 of the amount determined under § 46(c)(1). By multiplying 3/7 times the 7% credit generally available, the effect is a 3% credit for public utilities. The total depreciation allowed was 100% for property with a useful life of eight years or more, 66 2/3% for property with a useful life of six years or more but less than eight years, and 33 1/3% for property with a useful life of four years or more but less than six years.

The issue here is transportation and construction equipment having different useful lives, which qualifies as § 38 property and is thus eligible for the credit. The equipment is used to construct facilities which qualify as § 38 property and are also eligible for the investment tax credit. The constructed property here had useful lives of more than eight years at the time that it was placed in service and thus is eligible for the maximum investment tax credit.

The Supreme Court in Commissioner v. Idaho Power Co., 418 U.S. 1 (1974), determined that construction equipment had to be capitalized in determining the basis for depreciation of constructed property. However, the case did not determine our present problem. The reason for the *Idaho Power Co.* decision was that capitalization in the basis of the constructed property was the generally accepted method of accounting and the method required by the regulatory agencies. The Supreme Court also stressed that capitalization clearly reflected income. These reasons,

however, do not finally resolve the treatment of basis for investment tax credit because this was developed as a credit and not as a deduction to reduce federal income taxes. The accounting mechanics of investment tax credit were debated for many years and it does not resolve the proper basis for calculating the credit for tax purposes.

The Commissioner's position, as we have indicated above, is that the regulations in question are valid insofar as they prevent a double investment tax credit. Treas. Reg. 1.48-1(b)(4) provides:

> If depreciation sustained on property is not an allowable deduction for the taxable year but is added to the basis of property being constructed, reconstructed, or erected by the taxpayer, for purposes of subparagraph (1) of this paragraph a deduction for depreciation shall be treated as allowable for the taxable year with respect to the property on which depreciation is sustained. Thus, if $1,000 of depreciation sustained with respect to property no. 1, which is placed in service in 1964 by taxpayer A, is not allowable to A as being constructed by A (property no. 2), for purposes of subparagraph (1) of this paragraph a deduction for depreciation shall be treated as allowable to A for 1964 with respect to property no. 1. However, the $1,000 amount is not included in the basis of property no. 2 for purposes of determining A's qualified investment with respect to property no. 2. See paragraph (c)(1) of § 1.46-3.

The approach to consideration of validity of Treasury regulations requires that the validity of such regulations be presumed. It has been said that they " 'must be sustained unless unreasonable and plainly inconsistent with the revenue statutes.' " Fulman v. United States, 434 U.S. 528, 533 (1973); Bingler v. Johnson, 394 U.S. 741, 750

(1969). The regulations are not to be invalidated except for weighty reasons. This court has applied the standard applicable in considering Treasury regulations. Marshall v. Commissioner, 510 F.2d 259, 262 (10th Cir. 1975); Estate of Whitlock v. Commissioner, 494 F.2d 1297, 1300 (10th Cir. 1974), *cert. denied,* 430 U.S. 916 (1977); Harper Oil Co. v. United States, 425 F.2d 1335, 1343 (10th Cir. 1970).

The Treasury has broad authority from Congress to issue regulations pursuant to § 7805. Moreover, Congress has given the Treasury Department legislative authorization in § 38(b) to issue regulations pertaining to investment tax credit. Where, as here, the regulations have been issued pursuant to specific legislative authorization, the presumption of validity is even greater.

The purpose of the Treasury regulations now under consideration is clearly to prevent a taxpayer from taking double tax credit of the kind which the taxpayer in this case is seeking.[4] The statutory language applicable to the present subject does not contain a specific prohibition against a double credit. Nevertheless, the presumption in interpreting the statute and the regulations promulgated under the statute is opposed to such a double credit. The presumption is that statutes and regulations do not allow a double deduction. Charles Ilfeld Co. v. Hernandez, 292 U.S. 62, 68 (1934). Indeed the rule is that there must be a specific statutory provision authorizing a double de-

4. Another possible reason for the regulation, which has not been articulated by either the Commissioner or the Tax Court, is that the regulation may simplify recordkeeping and administration for this particular tax law. By requiring the credit to be taken on the construction equipment, when it is section 38 property, the credit applies to one property, whose acquisition, existence, and disposition can be relatively easily established. The credit is not based on the cost of the construction equipment after it has been allocated, either entirely or partially, to what may amount to a considerable number of construction projects, which may or may not result in § 38 property.

duction in order for it to be permissible. The reasoning is that a statute is not to be construed to allow a double deduction or credit which would reduce the federal income tax for one taxpayer.

Had Congress wished to provide the double credit the taxpayer seeks, it could easily have drafted a 6% credit instead of the 3% provided for public utilities. It nevertheless expressly provided a lesser credit for public utilities (3%) instead of the higher credit applicable to other industries, which was 7%. A 6% credit for utilities generally would undoubtedly be a more equitable way to provide double credit had Congress intended to do so rather than providing a double credit for those utilities who happen to use § 38 property for the purpose of constructing more § 38 property.

The argument that Congress would not object to a double credit inasmuch as it would stimulate more investment than a single credit does not persuade us. It was up to Congress to provide a double credit to stimulate investment had it been so minded.

It is necessary to discuss the two approaches which were taken by the Tax Court. Under either of these views, the one being the upholding of the regulations, the other the invalidating of one of the regulations to a limited extent, the federal tax consequences are the same. The taxpayer in each instance is denied double investment tax credit on the same capital outlay.

The majority of the court ruled that Treas. Reg. §1.48-1(b)(4) was valid because of its reasonableness and consistency with the statute and because, as a practical matter, it would operate to prevent gross abuses. As to Treas. Reg. § 1.46-3(c)(1), the majority held that this was valid to the extent that it prevented a double credit by claim-

ing investment tax credit on both the construction equipment and the constructed property. To that extent, Treas. Reg. § 1.46-3(c)(1) is reasonable and consistent with the purposes of the statute. The majority further held that Treas. Reg. § 1.46-3(c)(1) was invalid to the limited extent that the regulation excluded from the basis of constructed new § 38 property the depreciation sustained with respect to construction equipment on which no § 38 credit had been allowed.

The minority, or judges who concurred, would not have held any part of either of the regulations invalid because they were not shown to have been plainly inconsistent with the statute. 65 T.C. at 289-90. The concurring group of judges found that the two regulations, Treas. Reg. §§ 1.46-3(c)(1) and 1.48-1(b)(4), had to be construed in pari materia, since it was apparent on the face that they were intended to be so construed. Considering them together, it was said that it was clear that they were intended only to disallow double credit and to advise the taxpayer which property to claim the credit on rather than to deny any credit at all. 65 T.C. at 292.

According to the concurring viewpoint, the regulations deal only with the limited situation involving construction equipment which is § 38 property. In this case the regulations require the investment tax credit to be computed on the construction equipment even though the constructed property can also qualify as § 38 property.[5] The regulations, according to the concurring judges, do not attempt

5. The regulation can be a benefit or a detriment to the taxpayer depending on the useful lives of the two properties. If the construction equipment has a longer useful life than the constructed property, a higher applicable percentage may apply because of the regulation, and the taxpayer would receive a higher credit. If the construction equipment has a shorter useful life than the constructed property, the taxpayer may not receive the maximum credit on the expenditure for the construction equipment. The latter applies to this taxpayer.

to deny investment tax credit on the constructed property including the cost allocated from the construction equipment when the construction equipment does not qualify as § 38 property. Thus the concurring opinion construes the ambiguous regulation so that it is not plainly inconsistent with the statute.

The majority of the court ruled that Treas. Reg. § 1.46-3(c)(1) sought to cover the situation when the construction equipment was not § 38 property and was invalid to the extent that it did so. Denial of investment tax credit on constructed property which is § 38 property, because the construction equipment was not § 38 property, would treat the taxpayer who purchases and the taxpayer who constructs the property differently and would be contrary to the statute, since it would deny investment tax credit to property which qualifies for it. Furthermore, it would deny the tax parity for purchasers and constructors, which the Supreme Court has discussed in relationship to depreciation. Commissioner v. Idaho Power Co., 418 U.S. 1 (1974).

Both of the opinions of the Tax Court determine that there is support for the regulations growing out of the failure of Congress to change the applicable statutory language (and therefore the regulations) during subsequent years when it was making other changes in the investment tax credit. During the 13 years that the regulations have been in effect the investment tax credit was suspended, restored, repealed, reenacted, and substantially broadened. These actions required Congress to deal with basic problems, and yet no change in the applicable statutory language has taken place during all of the 13-year period.

Congress was not oblivious to the necessity for preventing multiple credits. Indeed § 47 provides for recapture (that is to say, certain increases in taxes) where

change occurred in the ownership of the property or the property ceased to be so-called § 38 property prior to the expiration of the useful life which was used to compute the investment tax credit. The purpose of this was to obviate quick turnovers of assets by those who were seeking to make excessive use of multiple credit.[6] Accordingly, when a taxpayer sells or exchanges § 38 property before the termination of its useful life, the recapture provisions can result in increased taxes.

There are other instances in which the Congress has acted for the purpose of preventing a double credit. One such example was in connection with § 48(c)(3)(B) to prevent a double allowance of investment tax credit in connection with trades of used property.

There are other double credit situations in which Congress made provision for reduction in basis for insurance proceeds. However, this was repealed in favor of making it subject to recapture. It could be argued that this is a double-edged sword. If Congress was so conscious of this, why didn't it close up this present crack? We are persuaded, however, that it is more cogent to conclude that Congress was cognizant of the problem and was not necessarily able to cover every possibility.

The Tax Court considered legislative history of a similar section, § 46(d)(3), which was effective for the taxable years ending after December 31, 1974. The state of mind of Congress is evidenced somewhat by what they did here, because they showed an intent to prevent the obtaining of double credit in circumstances not unlike the present one. This has some probative value here.

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6. S. Rep. No. 1881, 87th Cong., 2d Sess., *reprinted in* [1962] U.S. Code Cong. & Ad. News 3297, 3320; H.R. Rep. No. 1447, 87th Cong., 2d Sess., 1962-3 C.B. 405, 417.

The taxpayer argues that the use of the word "basis" in the investment tax credit statute necessarily includes capitalized depreciation from the construction equipment. It maintains that this result is required either because that is the word's meaning in its ordinary and customary sense or because that is the meaning applied by the Supreme Court in determining depreciable basis in Idaho Power Co., *supra.* Even if the use of the word "basis" in the statute is somewhat ambiguous or inconsistent with the meaning of basis in other contexts, like depreciation, the term "basis" cannot be construed to achieve a result, a double credit, which is contrary to what Congress intended. *See* Estate of Whitlock v. Commissioner, 494 F.2d 1297, 1300 (10th Cir. 1974), *cert. denied,* 430 U.S. 916 (1977).

The taxpayer relies on the decision in Walt Disney Productions v. United States, 480 F.2d 66 (9th Cir. 1973), *cert. denied,* 415 U.S. 934 (1974) for its determination of basis. The Ninth Circuit there held that the basis was to include the whole cost of the property produced (motion picture negatives) and the taxpayer was entitled to use its depreciable basis to compute investment tax credit. *Id.* at 69. The opinion did not say that this cost included depreciation on § 38 property and so presented the possibility of a double credit. The court did not invalidate the regulations under consideration or even consider them, so the possibility of a double credit to all outward appearance was not present.

In sum:

To the extent then that the regulations operate to prevent the double investment tax credit, they are reasonable, consistent with the statute and in harmony with congressional purpose and hence valid.

The preferred view, as we see it, is expressed in the concurring opinion of the Tax Court which does not invalidate either of the two regulations to any extent. The ambiguity in the regulations can be eliminated and the regulations can be upheld by following the congressional intent underlying the statute. Where there is an interpretation of an ambiguous regulation which is reasonable and consistent with the statute, that interpretation is to be preferred.

If the two regulations are read together and are treated as addressing the situation where the construction equipment is § 38 property (rather than nonqualifying property), the regulations are reasonable and consistent with the statute. The treatment of investment tax credit applied by the regulations in such cases presents a reasonable method of preventing the abuses that could result from permitting a double investment tax credit contrary to congressional intent.

The Tax Court properly rejected taxpayer's alternative argument which would have allowed taxpayer to maximize the investment tax credit by computing the credit in part on the construction equipment and in part on the constructed property, whereby it would receive the benefit of the longer useful life. The taxpayer argues that this method of computation, although clearly not in accordance with the regulations, should be acceptable because the result is not a double credit on the cost expenditure for the construction equipment. The result is, however, that the maximum credit is obtained on the construction equipment even though the useful life of the construction equipment entitles it by statute to less than the maximum credit.

The effect in computing the credit (ignoring recapture potential) is similar to capitalizing all the cost of the construction equipment in the cost of the constructed property and basing the credit on the constructed property. This is not the method of computation established by the regulations where both the construction equipment and the constructed property qualify as § 38 property. Since the regulations are reasonable, they should not be invalidated to the extent necessary to permit this proposed computation.

The taxpayer fails to mention how the investment tax credit should be computed when the construction equipment has a *longer* useful life than the constructed property. A taxpayer would no doubt argue (and correctly so) that the regulations allow a taxpayer to take advantage of the longer useful life of the construction equipment. Certainly a taxpayer would object if forced to recapture investment tax credit because part of the cost of the construction equipment was allocated to a constructed property with a shorter useful life. Thus, the effect of the taxpayer's proposal would be to maximize the credit and benefit from the longer useful life of the two § 38 properties.

The Tax Court's decision is approved, and the same is affirmed. We note, however, that our opinion has a slight difference from that of the Tax Court in that we have preferred the upholding of both of the Treasury regulations here in question as being consistent and reasonable with the statute. This difference in interpretation does not affect the result.